TOURISMOS: AN INTERNATIONAL MULTIDISCIPLINARY JOURNAL OF TOURISM
Volume 6, Number 3, Winter 2011, pp. 13-36
UDC: 338.48+640(050)

EARNINGS TARGETS IN SPANISH HOTEL INDUSTRY: AN APPROXIMATION

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In this paper, two earnings targets - avoiding losses and earnings decreases - are analyzed in Spanish hotel industry. The methodology used as a proxy to earnings targets is frequency histograms. Particularly, the existence of a "kink" in the distribution of reported earnings around zero is examined. The access to financial resources to start or to consolidate expansion policies is an important issue to the companies belonging to our sample. This specific scenario allows us to study how to reach earnings benchmarks under debt covenant hypothesis. Likewise, Spanish tourism sector is characterised by small firms and most of them are governed by families. We explore the relationship between earnings benchmarks and this particular ownership structure. Finally, we examine the presence of auditors (and Big4 auditors) as an earnings quality tool.

Keywords: *earnings benchmarks, frequency histograms, Spanish hotel industry*

JEL Classification: L83, M1, O1

INTRODUCTION

The role that financial information plays in global market is well-known. The current financial crisis has called to attention to the quality of the accounting information reported by firms over the world. The transparency of the information available to make appropriate judgments about firms' performance by investors is an open question.

Our study focuses on the quality of the financial reporting. Particularly, this paper examines earnings benchmark in the Spanish hotel industry. The benchmarking literature uses small positive differences

between reported earnings and any benchmark as a measure of earnings quality. The literature considers three basic earnings benchmarks: report small positive profits, report small increases in profits and "meet or beat" analysts' forecasts (Burgstahler and Dichev 1997; Degeorge et al. 1999; Barth et al. 1999; Myers et al. 2007).

The motivations that managers present to achieve earnings benchmark have extensively analyzed. Research documents that firms that consistently meet or beat prior period earnings have higher price-earnings ratios or market-multiples than matched samples (Barth et al. 1999; Myers et al. 2007). It is also noted that only if firms meet analyst expectations consistently, they are rewarded with high stock prices in the market (Kasznik and McNichols 2002). In contrast, if firms eventually miss a target, they loss immediately the market-reward (Myers et al. 2007). Recent studies reveal that markets incentives are the most important incentive to engage in earnings management. However, bonus plans, debt covenant hypothesis and political cost also explain an earning management strategy (Watts and Zimmerman 1986).

Considerable effort was spent on detecting the factors that can mitigate earnings management. Factors related to the accounting standards quality, the legal structure, the investor rights, the ownership equity, the importance and develop of equity markets, the enforcement mechanisms and the corporate governance, among others, explain different levels of earnings quality (e.g. Leuz et al. 2003).

This paper focuses on earnings benchmarks using a sample from Spanish hotel industry firms for the period 1999-2003. Several reasons justify focusing on Spanish hotel industry. Firms belonging to this industry are immersed in a growing process over local markets and abroad. The access to new financial resources to start, to promote, to intensify or to consolidate expansion policies could be a strong motivation to manage earnings. Also atomization characterizes Spanish hotel industry and that means weaker financial information regulation, at least far away from the regulation affecting large and audited firms. Finally, to avoid earnings tax paying could be a strong factor to increase earnings without limit (Coppens and Peek 2005).

The scenario provided by hotel industry allows us to design a specific study. First, we examine the avoiding losses hypothesis and earnings decreases hypothesis. The methodology used is frequency histograms. Particularly, the existence of a "kink" in the distribution of reported earnings around zero is analyzed (Burgstahler and Dichev, 1997).

Second, earnings targets are studied in the specific framework faced by Spanish hotel industry. The access to financial resources is an

important restriction in their expansion abroad. In this context, we use leverage as a proxy to debt covenants and we explore if higher leverage firms incur more in earnings management than lower leverage firms.

Third, Spanish hotel firms present a particular ownership structure. As well as most of the firms are characterized by a small size, family structure is the most predominant form to manage the firm. Our next objective is to analyze the association between reaching earnings benchmarks and the family's governance.

There are two competing theories about the incentives that managerial ownership provides for accounting choices: an entrenchment effect and an incentive alignment effect. These two effects predict different directions for the association between ownership concentration and earnings quality. Entrenchment effect theory suggests that controlling shareholders extrapolate private benefits at the expense of minority shareholders. In contrast, alignment effect theory suggests that controlling shareholders' benefits are closely tied to firm value. The evidence on which effect dominates is mixed.

Finally, we examine the association between earnings targets and audited-firms versus non-audited firms. Extent research examines the auditor function to mitigate earnings management. One of the most commonly studied features of auditors are audit firm size. Generally, studies support that firms audited by large auditor firms are associated to less earnings than firms with non-Big4 auditors (DeAngelo 1981a; Krishnan 2003). In this context, the presence of Big 4 auditors is taken into account.

The results show a statistically small number of firms with small losses and a statistically large number of firms with small profits. The evidence is more accentuated by higher leverage firms. Finally, for non-audited-firms earnings benchmarks are more pronounced than for audited-firms. Generally, the results suggest that Spanish hotel industry is concern about the earning figure in the financial reporting.

In this paper we contribute to this literature in two main ways. A further contribution of the study is to provide initial evidence on whether the phenomenon of avoiding losses and earnings decreases is important in a fundamental sector of the Spanish economic activity (more than 12% of Gross Domestic Product, 12% of employment and covers around 60% of Spanish commercial deficit during 2009). Most previous studies proceed from listed companies. Second, this paper provides evidence about the relationship between earnings benchmarks and debt covenant hypothesis. Also ownership structure and the presence of auditors are analyzed. In

sum, this paper provides an initial approximation to earnings benchmarks in the Spanish tourist sector.

The remainder of this paper is organized as follows. Section 2 discusses prior literature. Section 3 describes the design of our empirical research and sample selection. Section 4 discusses the descriptive statistics and the findings of our empirical tests, and Section 5 concludes.

LITERATURE REVIEW

Background

The earning quality around the world is still an open question. Market's regulators (such as Securities Exchange Commission) have expressed their concern about the reporting of financial information by firms due to their implication for global markets. Earnings are widely used as a key performance indicator of business success and stakeholders use earning figure to multiple purposes.

This paper covers earnings benchmark as a measure of earnings quality in Spanish hotel industry. Frequency histogram is the most common methodology to identify weather managers trying to achieve earnings targets. Burgstahler and Dichev (1997) document a "kink" in the distribution of reported earnings around zero. They find a statistically small number of firms with small losses and a statistically large number of firms with small profits. Burgstahler and Dichev (1997) interpret this evidence as firms with unmanaged earnings just less than the heuristic target of zero intentionally manage earnings just enough to report a small profit.

In the same way, small earnings increases (or avoiding small decreases in earnings) are considered as a proxy for earnings management. The hypothesis is based on the finding of a statistically unusual low number of firms with small decreases in earnings in relation to small increases in earnings. Similar predictions are considered for meeting or beating the analysts´ forecast.

Findings of Burgstahler and Dichev (1997) have been documented using large samples of firms and selected under different restrictions. For example, in US context, Ayers et al. (2006) get some evidence consistent with an association between earnings management through the use of accruals and these targets. Kerstein and Rai (2007) and Jacob and Jorgensen (2007) find that the kink in earnings around zero is strongest in the fourth quarter. Donelson et al. (2009) provide direct evidence of an association between earnings management and discontinuities in the

distribution of analyst forecast errors, earnings changes, and earnings levels.

Not only earnings benchmarks have been documented in local samples, but also in samples covering several countries. For example, Burgstahler et al. (2006) using a sample of private and public firms from 13 European Union countries, find that private companies manage earnings more which is consistent with less pressure for earnings quality. Coppens and Peek (2005) using a sample of private firms in eight European countries, find that in absence of capital market pressures, firms still have incentives to manage earnings. They argue that private firms avoid reporting small losses and tax incentives are a strong factor to engage in earnings management.

Prior literature suggests that meeting or beating targets has positive market consequences. Barth et al. (1999) and Myers et al. (2007) notice that firms that consistently report earnings increases relative to the prior year or relative to the same quarter of the prior year receive a price premium. The positive market consequences have risen as one of the most important incentive by managers to incur in earnings management.

The positive accounting theory literature examines management motives for making accounting choices (see Watts and Zimmerman 1986). Incentives such as compensation contracts, debt contracts, and political costs explain firms´ accounting choices when there are agency costs and information asymmetry.

Debt covenant hypothesis suggests that firm closer to violating debt covenants will make income-increasing accounting choices to avoid covenant violations. In this context, Sweeney (1994) provides evidence that firms make income-increasing accounting choices as they move closer to violating debt covenants. DeFond and Jiambalvo (1994) find that working capital accruals are higher in the year prior to the year that a firm reports a covenant violation in its annual report. In contrast, DeAngelo et al. (1994) find relatively little difference between accruals for firms with and without binding covenants. Jiang (2008) finds that firms beating earnings benchmarks have (a) better one-year ahead credit ratings; and (b) a smaller initial bond yield spread. However, he does not find that meeting or beatings reduced cost of debt to matched sample that non-managing earnings.

Also the association between firm size and accounting choice motivated by political visibility hypothesis has been extensively examined. Watts and Zimmerman (1986) argue that large firms will make income-decreasing accounting method choices in response to greater political/regulatory scrutiny. Mixed evidence has been found in relation to

firm's size. For example, Moses (1987) finds that firm size and market share (marginally) are associated with accounting method changes specifically to smooth (as opposed to decrease) earnings.

The managers´ motivation in Spanish hotel industry to engage in earnings management cannot be driven by market factor as only two firms are listed. The positive accounting theory can explain accounting choices to alter the financial information. Particularly, the internationalization process in which Spanish hotel industry is involved in and the problems to access to the equity market to finance it induces firms to face the bank-debt as the most common formula and may explain some earnings management conducts.

THE RELATION BETWEEN EARNINGS MANAGEMENT AND OWNERSHIP STRUCTURE AND AUDITORS

Spanish tourism sector is characterised by small firms and most of them are governed by families. This specific formula to manage firms has been analyzed by prior studies. There are two opposite theories about the incentives that managerial ownership provides for accounting choices: an entrenchment effect and an incentive alignment effect. The former defend that controlling shareholders extrapolate private benefits at the expense of minority shareholders. In contrast, alignment effect theory suggests that controlling shareholders' benefits are closely tied to firm value. The evidence on which effect dominates is mixed.

In this context, Ali et al. (2007) argue that family firms (compared to non-families firms) face less severe agency problems due to the separation of ownership and management, but more severe agency problems that arise between controlling and non-controlling shareholders. Their finding are consistent with the notion that family firms face less severe Type I agency problems and more severe Type II agency problem, but overall they face less severe agency problems than non-family firms. Less severe agency problems lead to less manipulation of earnings for opportunistic reasons and thereby higher earnings quality[i].

In sum, in terms of ownership structure and auditors, we are facing firms basically controlled by families' founders that are involved in more severe Type II agency problems and most of them are non-audited firms.

Finally, audit quality is an important dimension of financial reporting quality. Prior literature finds that auditor's incentives to report or correct errors depend on factors such as litigation risk, reputation costs, and auditor independence. For example, large auditors are perceived as being more independent (DeAngelo 1981a, 1981b), more experienced, higher

industry expertise (Krishnan 2003). It is also documented that Big 4 auditors are more conservative because they have to protect their brand name (DeAngelo 1981a, 1981b; Krishnan 2003).

Spanish hotel industry is characterized by non-audited firms due to the small firms-dimension. The control of the financial information for non-audited is not so strict in relation to other firms. This makes easier to alter the financial information.

DESING OF THE EMPIRICAL RESEARCH

This paper focuses on earnings benchmarks in Spanish hotel industry. We use SABI database (Iberian Balance Sheet Analysis System database) to collect financial information about Spanish hotel industry. We obtain 9,950 observations from 1999 to 2003.

First, we investigate the hypothesis of avoiding losses and earnings decreases. To do that, we focus on net income and changes in net income. The methodology used as a proxy to earnings benchmarks is frequency histograms. Burgstahler & Dichev (1997) find a discontinuity around the zero point in the distribution of earnings (levels and changes). They observe a statistically small number of firms with small losses and a statistically large number of firms with small profits. This evidence was interpreted as management strategy to meet earnings benchmarks. Under non-earnings management hypothesis, a smooth distribution of earnings around the zero point is expected.

We expect that the discontinuity at zero is more pronounced when the incentives to incur in earnings management increases. To build frequency histograms, we use the formula of Degeorge et al. (1999) to compute the frequency of observations in each partition of the histogram: 2(q3-q1)/ N-1/3, where q3 is the third quartile, q1 is the first quartile and N is the sample number. This formula is one of the most used in the empirical research on earnings benchmarks. The deflators of earnings are assets at the beginning of the year.

Second, as focusing on a particular industry with specific characteristics, we choose a possible key incentive to engage in earnings management. The access to debt-bank in the expansion process taken by Spanish hotel industry is an important issue. Then, we analyze the incidence of leverage as proxy to debt covenants in our two earnings benchmarks. To conduct our analysis, we split the sample according to the level of leverage and we examine the discontinuity in frequency histograms at zero point. We predict that high leverage firms could have

strong incentive to engage in earnings targets against the low leverage firms.

Third, we examine the ownership structure of Spanish hotel industry in reaching the earnings benchmarks. It could be noted that Spanish tourism sector is characterised by small firms and most of them are governed by families. The database provides information related to four types of owners: family, financial company, industrial company or a combination of them. We split the sample in two segments: family ownership and mixed ownership. As prior evidence present mixed evidence about the relation between family structure and earnings management, we do not predict any direction related managerial ownership.

Finally, it is assumed that firms that report audited financial statement, voluntary o mandatory, and high quality auditors (i.e., Big 4 auditors) will influence on earnings quality by constraining earnings management and persuading clients to report economic losses in a timely fashion. This paper introduces the presence of auditors as a control of earnings management. Specifically, we split the sample according to audited-firms and non-audited firms. We expect that audited-firms present less earnings management than non-audited firms. Also, we divide the sample by Big-4 auditors and non-Big4 auditors. We predict that Big 4 auditor[ii] contribute to mitigate earnings management.

Several critics are spilt around the identification to earnings management using frequency histograms. Dechow et al. (2003) find no relation between critical intervals and the use of discretionary accruals to achieve the benchmarks. Durtschi and Easton (2005 & 2009) suggest that the kink is due to statistical and sample bias. Holland (2004) considers necessary the use of different interval widths to make sure about the discontinuity. We considered this concern and we used different deflators and different interval widths as a control to frequency histograms.

FINDINGS

Table 1 shows the descriptive statistical. In Panel A, we can see that the mean of net income deflated by asset at the beginning of the year is 0.053, the mean of changes in net income deflated by asset at the beginning of the year is -0.009 and the mean of leverage is 0.5371. Panel B shows that 18.37% of the companies (1,462) present losses in net income against 81.63% of the companies (6,498) that present profits in net income. We can observe that 51.9% (4,133) report decreases in earnings as opposed to the 48.08% (3,827) that report increases in

earnings. The descriptive statistical analysis reveals that reporting earnings increases is not as relevant as reporting profits.

Panel C reports the ownership structure of the Spanish hotels firms. It is noted that the introduction of this variable in our study entails an important reduction of the observations due to the database did not provide all the information. We can see that family ownership (36.44%) is dominant in Spanish hotel firms, followed by mixed shareholding structure (family, industrial or financial firms). Comparing profitable firms with non-profitable firms, it can be observed that family ownership involved in firm control is the usual way to manage Spanish hotel firms (31.01%) or they can be managed by a combination of family, industrial or financial firms (26.01%). We use this segmentation to test the incidence of ownership structure on the earnings benchmarks.

The information related to audit (Aud) shows that 2,260 firms (28.39%) are audited-firms as opposite to 5,700 firms (71.61%) that are non-audited-firms (Panel C, last column). The presence of Big4 auditors are only 9.45% (Panel C, last column). It is noted that profitable firms are more audited than non-profitable firms.

Table 2 shows the earnings distribution of net income building under different assumptions. In Panel A, net income is deflated by assets at the beginning of the year and the interval widths are calculated by Degeorge et al. (1999). Both frequency histograms present a kink at zero point being more pronounced in net income levels than in earnings changes. The significance of this irregularity is confirmed by a statistical test ($p < 0$).

Panels B and C (Table 2) show some controls over histograms frequency. In Panel B, we follow the indication of Burgstahler and Dichev (1997) and Holland (2004) in order to determinate the interval widths. The interval widths are 0.01 for net income and 0.005 for changes in net income. The earnings' deflator is assets at the beginning of the year. In Panel C we do not use any deflator as previous paper showed that can generate a bias in earnings distributions. The interval widths are determinate using Degeorge et al's formula.

All figures present a kink at zero point being more pronounced in net income levels than in earnings changes. The significance of this irregularity is confirmed by a statistical test ($p < 0$). The evidence indicates that avoiding loss hypothesis is more relevant to Spanish hotel industry than avoiding decrease in earnings. It is also noted that the interval widths and the deflator used generate differences in earnings distribution.

Table 1 Statistical descriptive

Panel A: Basic statistical descriptive

	mean	median	std. dev.	q1	q3
NI	0.0530	0.0360	0.1362	0.0063	0.0887
ΔNI	-0.0009	-0.0014	0.1340	0.0204	-0.0260
Lev	0.5371	0.5530	0.2738	0.3056	0.7641

Panel B: Losses and Decreases in net income (NI)

	NI < 0		NI > 0		
	n	%	n	%	Total
NI	1,462	0.1837	6,498	0.8163	7,960
Δ NI	4,133	0.5192	3,827	0.4808	7,960

Panel C: Ownership structure and audit

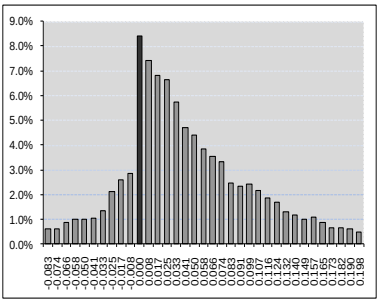
	NI < 0		NI > 0		Total	
	n	%	n	%	n	%
Financial	76	0.0150	264	0.0521	340	0.0670
Industrial	263	0.0519	949	0.1871	1,212	0.2390
Familiar	275	0.0542	1,573	0.3101	1,848	0.3644
Mixed	353	0.0696	1,319	0.2601	1,672	0.3297
	967	0.1907	4,105	0.8093	5,072	100%
Audited	459	0.0577	1,801	0.2263	2,260	0.2839
Non-audited	1,003	0.1260	4,697	0.5901	5,700	0.7161
	1,462	0.1837	6,498	0.8163	7,960	100%
Big4	207	0.0260	545	0.0685	752	0.0945
Non-Big4	252	0.0317	1,256	0.1578	1,508	0.1894
	459	0.0577	1,801	0.2263	2,260	0.2839

Note: NI is net income deflated by asset at the beginning of the year (NI/AT_{t-1}); ΔNI is the change in net income deflated by asset at the beginning ($\Delta NI/AT_{t-1}$); Leverage (Lev) is calculated as Total Debt / Assets

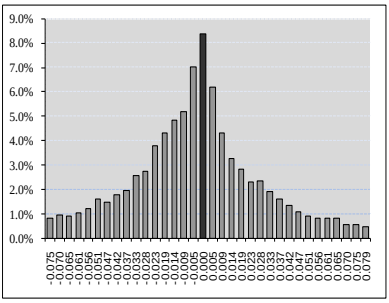
Table 2 Frequency histograms (net income)

Panel A: Net income distribution. Interval widths using Degeorge et al.´s (1999) formula

NI/ATt-1

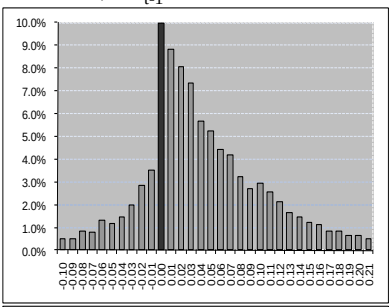


ΔNI/ATt-1

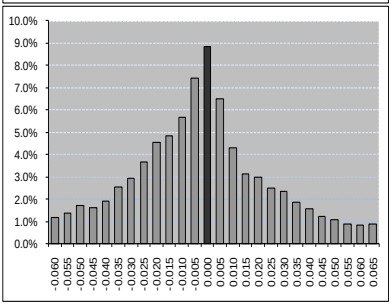


Panel B: Net income distribution. Interval widths 0.01 for net income and 0.005 for changes in net income

NI/AT_{t-1}

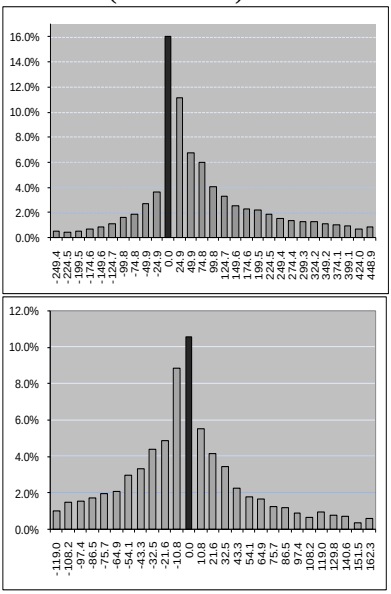


$\Delta NI/AT_{t-1}$



Panel C: Net income distribution (undeflated). Interval widths using Degeorge et al.´s (1999) formula

NI (Undeflated) ΔNI (Undeflated)



The histograms were generated from a data pool of 9,950 observations. The interval widths, following the Degeorge et al.´s (1999) formula, are 0.0083 for NI and 0.0047 for ΔNI (figures reported on Panel A); 0.01 for NI and 0.005 for ΔNI (figures reported on Panel B) and 24.94 for NI and 10.81 for ΔNI (figures reported on Panel C). We report two standardized differences: the first number corresponds to Burgstahler and Dichev´s (1997) formula and the second one correspond to Beaver et al.´s (2007) formula. The standardized differences in the interval immediately to right to zero are 9.23 and 8.41 for NI and 4.88 and 4.39 for ΔNI for figures reported on Panel A; 9.96 and 9.00 for NI and 5.00 and 4.51for ΔNI for figures reported on Panel B.

Table 3 presents earnings distribution of net income constrained by level of leverage. The quartile measure is used to split the sample in low and high leverage. Panel A reveals that the discontinuity at zero point is more accused in firms with higher leverage. Particularly, the kink is only statistical significant ($p < 0.01$) for firms with higher leverage. The difference between both regions tested by Chi-square is statistically significant ($p < 0.01$).

Panel B shows similar results for changes in earnings distributions. The discontinuity at zero point disappears for lower leverage firms and the discontinuity at zero point is statistical significant ($p < 0.01$) for firms

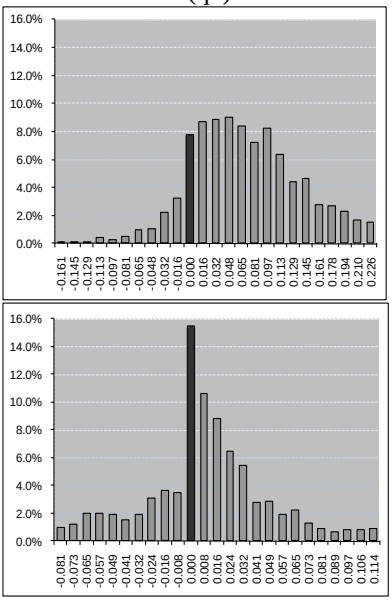
with higher leverage. The difference in two regions tested by Chi-square is statistically significant ($p < 0.01$).

The evidence suggests that higher leverage firms achieve earnings benchmarks more frequently than lower leverage firms. Particularly, firms with higher leverage prefer to report small profits and increases in earnings against the opposite situation (small losses and small decreases in earnings). In the annex (Table 6) similar evidence is shown using interval widths of 0.01 for net income levels and 0.005 for changes in net income.

Table 3 Frequency histograms (net income) constrained by leverage

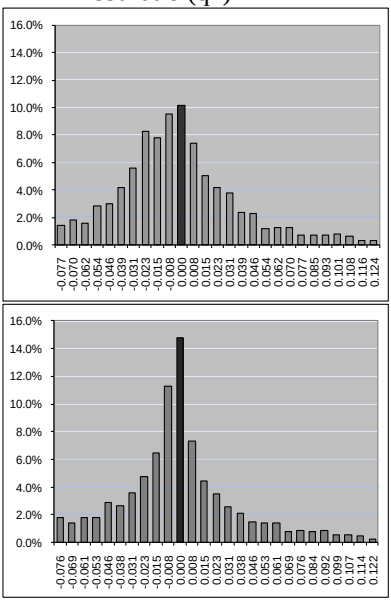
Panel A: Net Income distribution (NI/AT_{t-1})

Debt ratio (q1) Debt ratio (q3)



Panel B: Changes in Net Income distribution ($\Delta NI/AT_{t-1}$)

Debt ratio (q1) Debt ratio (q3)



The histograms are generated from 1,990 observations. Panel A shows net income distributions (NI/ATt-1). Panel B represents changes in net income distributions (ΔNI/ATt-1). The frequency histogram on the left represents low leverage firms (Debt ratio < quartile 1) and the frequency histogram on the right represents high leverage firms (Debt ratio > quartile 3).

The interval widths are calculated following the Degeorge et al.´s (1999) formula. In Panel A, the interval widths are 0.016 for NI and 0.008 for ΔNI. In Panel B, the interval widths are 0.008 for both NI and ΔNI. In a sensitivity analysis, frequency histograms are built using another two measures (mean and median) to discriminate between high and low leverage firms. Similar results are obtained.

Table 4 reports the incidence of ownership structure in reaching the earnings benchmarks (levels and changes). As we explained, the database used in this study provides limited-information related to the owners of the firms. The introduction of this variable produces a sample-reduction (see Table 1, statistical descriptive).

In Table 4, we can see that the discontinuity of earnings distribution in earnings level as well as in earnings changes is more accentuated in family structure than in others ownership structures. In the annex, Table 7 shows similar results using the alternative interval widths. This evidence must be interpreted with caution due the difficulties found when picking up the data.

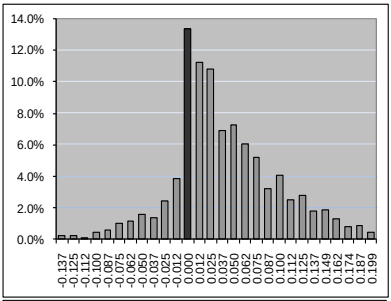
Table 5 (Panels A and B) reports the relation between earnings benchmarks and the presence of auditors in the financial statements. It is noted that the discontinuity in net income (levels and changes) for non-audited firms is bigger than for audited-firms. This evidence can be interpreted such as auditors provide quality to earnings.

Finally, Panels C and D (Table 5) present the relation between earnings benchmarks and the presence of Big 4 auditors. It is noted that Big 4 produce mixed results. As the discontinuity in net income decreases under Big 4 auditors, the evidence using changes in net income is not as evident. Further exam is required. Table 8 (annex) shows similar results using the alternative interval.

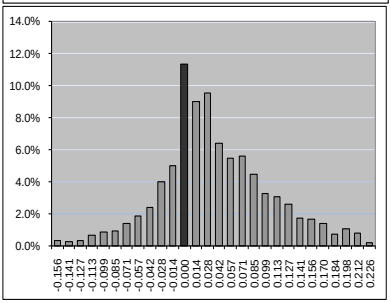
Table 4 Frequency histograms (net income) and ownership structure

Panel A: Net Income distribution (NI/AT_{t-1})

Familiar

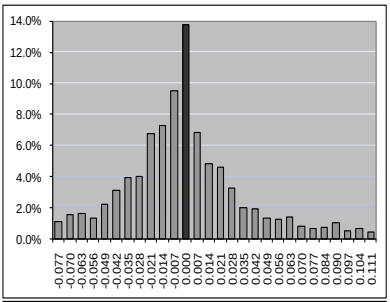


Mixed

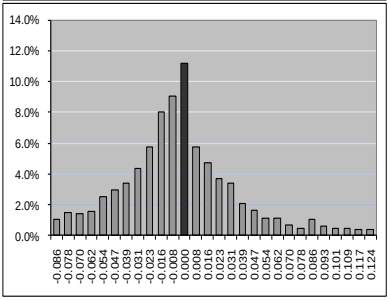


Panel B: Changes in Net Income distribution ($\Delta NI/AT_{t-1}$)

Familiar



Mixed



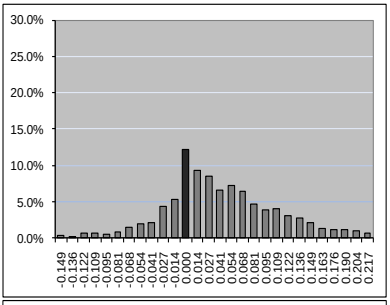
The histograms are generated from 1,848 observations for family structure and 1,672 observations for mixed structure. Panel A shows net income distributions (NI/AT_{t-1}). Panel B represents changes in net income distributions ($\Delta NI/AT_{t-1}$).

The interval widths are calculated following the Degeorge et al.´s (1999) formula. In Panel A, the interval widths are 0.0125 for family structure and 0.0141 for mixed structure. In Panel B, the interval widths are 0.007 for family structure and 0.008 for mixed structure.

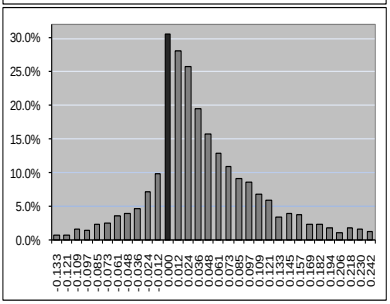
Table 5 Frequency histograms (net income) and the presence of auditors[iii]

Panel A: Net Income distribution (NI/AT_{t-1})

Audited-firms

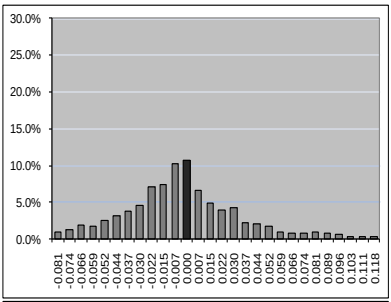


Non-audited firms

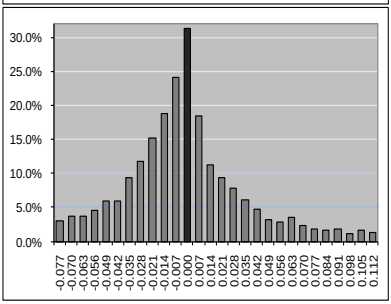


Panel B: Changes in Net Income distribution ($\Delta NI/AT_{t-1}$)

Audited-firms

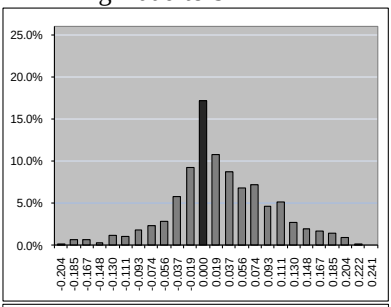


Non-audited firms

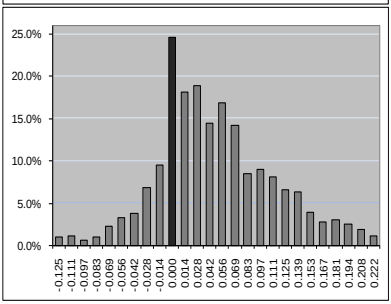


Panel C: Net Income distribution (NI/AT_{t-1})

Big 4 auditors

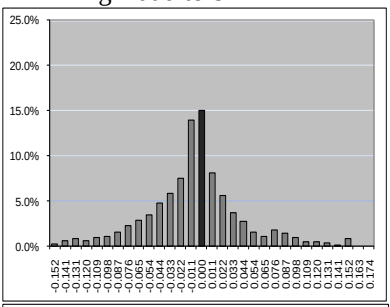


Non Big 4 auditors

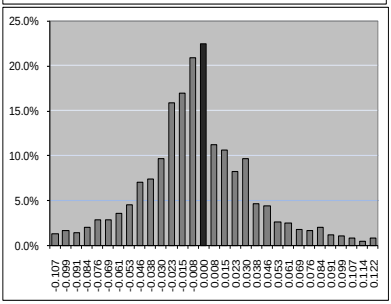


Panel D: Changes in Net Income distribution ($\Delta NI/AT_{t-1}$)

Big 4 auditors



Non Big 4 auditors



CONCLUSIONS

This paper focuses on earnings benchmarks in Spanish hotel industry. We examine a fundamental industry for Spanish economy (its contribution to GDP is around 12% and it is essential for employment (12%) and balance of payments covering 60% of commercial deficit in 2009). This industry presents special characteristic that can justify a particularly analysis. Since mid-nineties, Spanish hotel firms are involved in a globalization process. Bank debt becomes the main source of financing for this industry in their expansion abroad due to the small dimension of the firms. The difficulties to access to financial markets to find resources and their dependence to financial firms are pressure factors that can motivate managers to carry out adjustments in the reported financial information. It is also noted that small firms do not have strict controls and supervisions over the financial reporting.

This paper examines earnings benchmarks in Spanish hotel industry as a proxy to earnings management using frequency histograms. The evidence suggests that avoiding losses hypothesis is more relevant than avoiding earnings decreases hypothesis. It is also noted that earnings

management are more pronounced in firms with high leverage ratios than in firms with low leverage ratios.

Interesting results are found between achieving the benchmarks and the ownership structure. No differences have been found between family owners and mixed owners. This result must be interpreted with caution due the difficulties in obtaining the data related to ownership structure. Finally, it is noted that auditors provide quality to the financial reporting. Non-audited firms engage in more earnings management.

This paper examines one of the most controversial subjects nowadays. The quality of the financial information concerns to a large number of stakeholders due to their importance to take decisions in global markets. This paper supports the hypothesis that managers are not indifferent when facing earnings figures. It is noted that there is a preference to report small profits against small losses and it is more pronounced under certain incentives.

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ENDNOTES

[i] Ali et al. (2007) explain that there are two main types of agency problems in public corporations. The first type of agency problem arises from the separation of ownership and management (Type I agency problem). The separation of corporate managers from shareholders may lead to managers not acting in the best interest of the shareholders. The second type of agency problem arises from conflicts between controlling and non-controlling shareholders (Type II agency problem). Controlling shareholders may seek private benefits at the expense of non-controlling shareholders.

[ii] We use the term Big 4 throughout this paper to refer to Deloitte Touche Tohmatsu, Ernst & Young, KPMG, and PricewaterhouseCoopers. But Big 4 included Arthur Andersen before 2002.

[iii] In Panels A and C, frequency histograms are generated from 1,462 observations for audited-firms and 6,462 observations for non-audited firms. In Panels B and C, frequency histograms are generated from 752 observations for Big 4 auditors and 590 observations for non-Big 4 auditors. The interval widths are calculated following the Degeorge et al.´s (1999) formula. In Panel A, the interval widths are 0.0136 for NI and 0.0121 for ΔNI. In Panel B, the interval widths are 0.018 for NI and 0,008 for ΔNI. In Panel C, the interval widths are 0.007 for both NI and ΔNI. In Panel D, the interval widths are 0.011 for NI and 0.009 for ΔNI.

SUBMITTED: APRIL 2010
REVISION SUBMITTED: JUNE 2010
ACCEPTED: OCTOBER 2010
REFEREED ANONYMOUSLY

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